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DIRECTORATE OF INTELLIGENCE

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China: New Agricultural Reforms [redacted] 25X1

Summary

Having spent the latter half of 1984 touting urban industrial reform, Beijing has again made agriculture the focus of its first major economic policy statement of 1985. An authoritative party document publicly addresses major problems that have begun surfacing in the agricultural sector over the past two years and significantly alters the relationship between the government and China's farmers. In an effort to reduce the increasing surplus of grain and cotton and to limit growing government subsidies to agriculture, Beijing has announced that it will cut back on both the amount and the average price of agricultural products it is obligated to buy. From now on, production contracts will replace state quotas, and Chinese peasants will be required to sell any above-contract production on a free market, rather than to the state. The new policies stipulate more government incentives to encourage peasants to produce better quality products and to make more efficient use of their land. [redacted] 25X1

The price reductions and greater uncertainty that accompany the government's call for peasants themselves to market their surplus output may already be having a dampening effect on grain and cotton production, and farm incomes in areas

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This memorandum was prepared by [redacted] China Division, Office of East Asian Analysis. Comments and questions are welcome and should be addressed to the Chief, Domestic Policy Branch on [redacted] 25X1

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producing the two crops probably will fall this year because of decreased acreage devoted to these crops. Whether this downward pressure will result in actual declines in output or merely reduced rates of increase is difficult to determine. Recent Chinese press reports indicate a serious concern in the leadership that actual production declines could occur, a development that could adversely affect other important economic reforms. Whatever the outcome for grain and cotton, we anticipate that the new program will spark increases in the production of livestock, chickens, and vegetables and may encourage peasants to increase their involvement in the transportation and storage of grain and cotton--thus meeting Beijing's goals. 25X1

Central Document No. 1--Setting New Agricultural Policy

For the fourth consecutive year, China has focused priority attention--in the form of Central Document No. 1--on agricultural reform.[1] The full text, published in late March, and earlier comments in the Chinese press by Premier Zhao Ziyang and Vice-Premier Wan Li indicate that major changes are planned in the relationship between the government and China's farmers. 25X1

The state will no longer fix mandatory quotas for farm produce, including grain and cotton. Instead, peasants will negotiate targets with state commercial departments and then sign quantity and quality contracts. This year, for example, the state plans to purchase 75-80 million tons of grain under the contract system. The state will buy only the amounts contracted for. Any excess will be retained by the farmer for his own use or for sale in free markets. The state will no longer purchase nonstaple products such as vegetables, pork, chicken, fruit, and aquatic products. Instead, market demand and supplies available will determine prices. 25X1

The pricing formula for grain, oil seeds and cotton will also be changed. Depending upon the quality of the product, there will be a single price set by the state, agreed to in contract. Peasants will no longer receive a guaranteed bonus price for increases in their output. In the past, this bonus

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[1]Central Documents (zhong fa) are the most authoritative party guidelines for particular areas of policy concern. Published by the party's General Office, they are highly classified and restricted in circulation. In a break with normal procedure, however, China has for the last three years published Central Document No. 1--on agriculture--after relatively open discussion in the party press. 25X1

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price has been as much as 50 percent higher than the procurement price, which was itself inflated to spur production. Some observers have suggested this bonus price was in large part responsible for the rapid growth in agricultural production the last few years. The government has admitted that the practice has caused China to have serious budget deficits. 25X1

The new pricing policy would appear to introduce greater risks and uncertainties for the peasants, who now will have to make production decisions against uncertain market conditions. There are still, however, several safeguards: If market prices fall below production costs, or below the old quota price, which is in effect the new floor price, the state will buy all the grain that is offered for sale until prices rise above the floor price. The state also will try to regulate the market by purchasing and selling commodities on the market in order to stabilize prices and will now guarantee food supplies to farmers switching from grain and cotton to forestry, animal husbandry, or even nonagricultural pursuits. 25X1

The Motives for Additional Change

We believe Beijing had several motives for introducing the new policies. First of all, they are attempts to alleviate the few serious problems that have accompanied the otherwise highly successful agricultural reforms of 1978-1981. 25X1

By forcing producers to market above-contract grain on their own, Beijing hopes to lessen the strain that six consecutive bumper harvests have placed on its centralized procurement, marketing, and storage systems. Surplus grain has clogged rail and water transportation networks and overwhelmed state granaries. There have been reports of grain rotting in make-shift storage facilities because local granaries are full and peasants have neither the means of transportation nor the commercial networks necessary to ship to local markets. The problem has been compounded by state pricing practices, which--by holding procurement prices above those on free markets--have encouraged peasants to sell their entire output to the state rather than trying to arrange commercial transportation on their own. 25X1

The new procurement practices, and the policy of paying lower average prices for grain, also represent an attack on burgeoning financial problems that have come after recent agricultural gains. Beijing's policy of holding retail grain prices artificially low to protect urban consumers while raising procurement prices to benefit farmers meant that output gains automatically demanded increased subsidies. Bonus prices for above-quota production exacerbated the problem. The gap required subsidies of more 140 billion yuan between 1979 and 1983 and was a major factor behind six consecutive budget deficits, totalling about 80 billion yuan. 25X1

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The decision to change agricultural pricing practices was also driven by the party's commitment, formalized at the Third Plenum of the 12th Central Committee last October, to undertake comprehensive price reform. The regime evidently believes that the agricultural sector is the easiest area in which to initiate risky price reforms, owing to:

-- Successes achieved with earlier rural reform when peasant enthusiasm for market-oriented programs resulted in quick and positive responses to new policies.

-- The surplus grain and cotton crops, which ensure that there will be no shortages and thus no spiraling upward of prices.

-- Previous price adjustments that set state procurement prices for agricultural crops much closer to their true market value than those of industrial products or raw materials. Further price changes in response to market signals should be less than in some other sectors. 25X1

Beijing also intends the new policies to promote agricultural "diversification," reduce reliance on subsistence grain farming, and support the growth of a "socialist commodity economy." Party leaders have long recognized the need to improve the variety and nutritional value of the Chinese diet but have resisted changing agricultural policies to avoid causing grain shortages. The new policies, buttressed by agricultural surpluses, are intended to encourage local areas to seek their "comparative advantage" in agricultural production, rather than trying to become totally self-sufficient in grain. 25X1

By contracting with peasants, the state can reduce grain production in areas that are unsuitable to growing it, and promote production of more appropriate crops. The long-range plan is to create "commodity base areas" that will specialize in raising particular crops. For example, instead of growing grain inefficiently, mountainous areas will be encouraged to cultivate forests, while grassland areas will be urged to raise more livestock. The new policies stipulate that those peasants who undertake conversion of the land they farm will be provided subsidies by the state, in the form of loans, seeds, technical advice, and insured grain supplies. 25X1

Finally, by lowering farm incomes of less efficient producers Beijing reinforces its effort to push peasants into nonfarming employment. Beijing wants to reduce the proportion of its rural population engaged in agriculture from the current 80 percent to 30 percent by the year 2000. Under Beijing's plan, 40 percent would be engaged in industrial and commercial activities in rural towns and the remaining 30 percent would be involved in animal husbandry, forestry, fisheries, etc. 25X1

Getting the Program in Place

Although the regime's new policies appear to us to be well-considered, and reportedly already have been tried experimentally in some provinces, including Guangdong, potential problems remain that could hamper implementation of the program. It may be difficult to convince peasants to go along with the new policies. In the past, farmers responded enthusiastically to reforms--such as the responsibility system--that were obviously to their benefit. The advantages of price reform may not be as apparent, and the risks may appear worrisome. For example, in areas of poor transportation and communication networks, it may be difficult to induce peasants to risk open market activity. It may also be hard to persuade conservative farmers in poor areas to give up grain cultivation, even if inefficient, and depend on state supplies and aid to develop other production. 25X1

In our view, political problems also will have an effect on the implementation of the agricultural price reform program. There are probably still some in the Politburo who have serious reservations about the ideological propriety and economic advisability of the new policies. This attitude will be even more prevalent at lower levels of the party hierarchy. Provincial reaction to Central Document No. 1 has been relatively slow and cautious, compared with previous years, suggesting that there is both confusion about and possibly some resistance to implementation of the new policies. 25X1

The Risk of Declining Output

Beijing appears to be quite concerned that peasants may over-react to the new policies and bring on serious supply problems. Articles in early March exhorted peasants and cadres alike to adhere to state guidelines and avoid reducing the acreage of good land sown to grain in hopes of gaining higher profits by raising cash crops. The articles hinted that the government is considering raising grain prices to insure that steep declines in production do not occur. 25X1

Grain supply shortages would be a serious setback to all other reform efforts in China. Not only would the ripple effect complicate industrial price and wage reform efforts in the cities, but political and personnel reforms planned by Deng Xiaoping for later this year might also be affected. In the past, reformers justified calls for continued policy change by citing successes achieved in agriculture. Declines in grain production as a result of the most recent reforms would certainly be used by opponents of reform as evidence that the program had gone too far. The government, therefore, appears to be taking preventive steps to insure that agricultural production does not get out of control. 25X1

The lifting of price controls on pork and vegetables may create price and supply problems in urban areas. There are

already numerous reports of hoarding and price gouging, and the government has taken firm action to prosecute those who take advantage of the new policies to make excess profits. In expectation of short-term meat supply problems, ration coupons were reintroduced in 21 major urban areas in late January. It has also been reported that the state is prepared to increase wages in some urban areas to offset higher farm commodity prices. Although this will add to the government's subsidy burden, it is indicative of the cautious approach Beijing believes it needs to take to prevent any panic-driven reaction to change. [redacted] 25X1

Prospects

Despite the short-term risks, we believe that the new policies have good prospects for relative success. If consistently implemented, they probably will:

-- Lower state subsidies. With state procurement limited and bonus prices eliminated, average prices paid will stop growing, reducing government costs. [redacted] 25X1 25X1

-- Ease storage. With the state paying less for grain, many farmers will switch to other crops for better income, easing pressure for additional grain storage facilities.

-- Increase vegetable and pork stocks. Although pork and vegetable prices may rise sharply at first, increased production will bring supplies up and prices back down within a few months.

-- Get peasants involved in marketing, rural industry, and scientific farming. Allowing peasants to sell their surplus produce on the open market will encourage more peasant interest in marketing and prices. Many others will use more scientific farming to upgrade quality in order to receive higher prices. More "specialized households" and rural industries will appear as peasants see enhanced income outside of farming.

-- Diversify transport. Private transportation services will probably develop in response to increased market activity, easing the burden on state transport systems. [redacted] 25X1

Although the long-term intent of the policies is to diminish government interference in rural production, the short term will see considerable state activity. For example, agriculture officials have indicated that, to control local hoarding and price gouging, they are prepared to flood local markets with state grain, if necessary. Moreover, the regime has demonstrated repeatedly that it will take forceful action to punish those who take advantage of reforms to speculate in commodities or take

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excess profits. Government spokesmen have made clear that they expect many problems as the new policies take effect and are prepared to assist and adjudicate wherever necessary. 25X1

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